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EMPLOYMENT AND LABOR LAW REFORM IN NEW ZEALAND

Richard A. Epstein *

A ROUGH ROAD TO REFORM

My task on this occasion is to talk about law reform in New Zealand, which invites you, the audience, to ask what a nice boy from Brooklyn knows about this subject. But in fact there is a close synergy between my previous work and the topic at hand. During the 1980s I wrote two controversial articles (and one rejoinder) on labor and employment law.¹ Partly in consequence of my free-market message, in 1990, 1995, and 1999, I traveled to New Zealand at the behest of the New Zealand Business Round Table to speak about these subjects among others. I was their foreign carpetbagger, as it were, who was asked to bring his own perspective – a libertarian, philosophical outlook informed by a consequentialist, intellectual orientation – to bear on the problems of the day. I addressed many topics on those visits, for there were many areas of economic policy that were highly contested at the time. But one recurrent theme on all three visits was the state of New Zealand employment law. My purpose was to persuade New Zealanders, and the people in charge of New Zealand's political institutions, to engage in what the 19th Century lawyers used to call "liberalization" of their labor laws, that is, that the classical regime of freedom of contract should govern employment relations.² That project rested on the explicit assumption that New Zealand should remove most, if not all, the regulations and collective bargaining from its current law.

There was, actually, an ironic touch to all of this. I have known only one prime minister in my entire life – Geoffrey Palmer, who was then not only a torts professor who had from time to time visited the University

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¹ Richard A. Epstein, *A Common Law for Labor Relations: A Critique of the New Deal Legislation*, 92 YALE L.J. 1357 (1983); Richard A. Epstein, *Common Law, Labor Law, and Reality: A Rejoinder to Professors Getman and Kohler*, 92 YALE L.J. 1435 (1983); Richard A. Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947 (1984).

² The published lectures include: Richard A. Epstein, *Age Discrimination and Employment Law* (1999); Richard A. Epstein, *Restoring Sanctity of Contract in Employment Relationships* (1999); Richard A. Epstein, *Employment Law – Courts and Contracts* (1996).

of Iowa, but also prime minister of New Zealand. Part of the goal of my 1990 visit to New Zealand was to build the case against his Labor Party, in the hopes that New Zealand's National Party would introduce a leader more receptive to their reform programs. That change did take place in national elections in the fall of 1990.

Although I felt very strange about this personal connection, it gave me a chance to observe over the better part of a decade the full cycle that had developed in New Zealand, including those actions and policies that had been entrenched before the push for reform. I am going to recount some of this history for you. Before I start addressing the New Zealand reform, however, I think it would be useful to talk briefly about how we think about the law reform movement generally in the United States, and why a comparative approach is useful for understanding the New Zealand situation.

In dealing with law reform, the natural target for discussions is of course the United States, where the progress toward reform, whether for better or for worse, faces a powerful set of institutional obstacles that even the most ardent reformer cannot easily overcome. The first of these is that we have a federal system so that law reform has to come either piecemeal at the state level or after Herculean struggle at the federal level. At both the state and federal levels, moreover, the organization of government slows down reform. The complex committee structures, bicameralism, presidential and gubernatorial vetoes, all contribute to a situation in which the advantage goes to the status quo ante. We also invite judicial challenges to the legislation and regulation on a wide variety of administrative law and constitutional grounds. The history of tort reform shows the huge scars of battle, and the ability to obtain any kind of reform in an area as contentious as labor law is even more problematic. The bias to the status quo ante is evident.

For these reasons, it is instructive to look at the pace and style of law reform in countries that have very different political constitutions. For these purposes, New Zealand is about as good a contrast to the United States as one can hope to see. It is a common law country in the sense that it obviously inherited the English common law, to which it retains a much closer affinity than does the United States. It is a small country with under four million people. The system is not federal. The New Zealand Parliament has a single house. There is a prime minister in Parliament, which means (or at least meant until a system of proportionate representation was introduced) that the dominant party can turn the law around on a dime. The pace of law reform in New Zealand could be much more rapid than in the United States – regardless of whether it moved the law for better or for worse. So, one determinant of the rate of change – which is not synonymous with “reform” – points to the potential for rapid change in New Zealand, at least in those instances when change occurs.

The second element that affects the rate of reform is the perceived level of desperation with the particular problem at hand. When we “do” reform in the United States, we work against the basic backdrop of prosperity. Occasionally, you will see a degree of urgency with respect to reform in the United States, as for example the current (as of 2002, and perhaps not 2001) uproar over class actions, especially in places like Mississippi. The level of dissatisfaction is a rough measure of the anticipated gains from legal change; where it is high we can expect to see both the effort and stout resistance to it. But in some fraction of cases, the changes that are introduced could be substantial. But in most American settings, the general aura of prosperity dulls the urgency for major reform even in impacted sectors.

In comparison, when New Zealand engaged in its reform, the country was experiencing some truly major-league problems. Back in the mid-1980s, the nation was close to bankrupt and something very dramatic had to be done before the country went into hock. So, when you combine the motivation for reform with the existing government structure, New Zealand exhibited the two ideal conditions for reform. The desperation that concentrates attention on the problem, the political institutions capable – at least at the time – of rapid orientation or re-orientation towards the immediate perils at hand.

So that brings us to the earlier caveat: what it is exactly that you mean by “reform.” This is a problem of very different dimensions. Clearly, the most obvious point about a reform is that it changes the status quo. Quite literally, we “re-form” something so that it takes a new form. That is the origin of the term, but law reform for most people has a more high-minded purpose, so that it represents not just a change in, but also an improvement in the structure or design of the law. Well, it is easy to identify a change. It is rather more difficult for one to identify improvements without some clear, substantive diagnosis about what is wrong with the current system and what is right about the proposed change. This theory also had to command at least a very strong consensus within the society, if not unanimous consent, in order to be capable of adoption.

A CAPSULE HISTORY OF NEW ZEALAND EMPLOYMENT LAW

In light of these background conditions – particularly in New Zealand – it is difficult to secure a consensus that will move the law in (what I regard to be) the proper direction. In order to set the background, it is useful to offer a compressed review of the history of employment legislation in New Zealand, which is marked by wide swings in official policy. New Zealand's short-lived Employment Contracts Act (1991)³ (now

³ Employment Contracts Act, 1991 (N.Z.), available at <http://rangi.knowledge-basket.co.nz/gpacts/public/text/1991/an/022.html>.

guted by the Employment Relations Act 2000)⁴ did much to liberalize in the nineteenth century sense the world of employment relations.⁵ The ECA represented a sharp shift from previous New Zealand policy that in 1894 passed the Industrial Conciliation and Arbitration Act, under which unions gave up on the right to strike in exchange for a regime of compulsory arbitration.⁶ In 1936, New Zealand's first Labor Government made unionization compulsory. In 1973, the Industrial Relations Act distinguished what were called "disputes of interest" from "disputes of right." The former covered negotiations of new deals, or the extension of old contracts to new firms; the latter, individual grievances. The 1973 Act allowed strikes for disputes of interest, i.e. over economic issues, but not of right, i.e. disputes over the interpretation of individual contracts. By the middle 1980s, the basic legal system gave unions for key privileges, which Raymond Harbridge and Aaron Crawford summarized as follows:

The Industrial conciliation and Arbitration Act 1894 established the principles of wage fixing in New Zealand – conciliation and arbitration. Those principles were based on four features: (i) multi-employer arbitral awards which provided minimum terms and conditions of employment; (ii) subsequent party clauses which, by law, extended blanket coverage of awards over specified industries or occupations, regardless of whether they had participated in the process of award negotiation; (iii) procedures designed to make membership in trade unions compulsory; and (iv) compulsory arbitration to settlement disputes of interest.⁷

The nationwide system of wage agreements came under siege during the 1980s, when the New Zealand economy edged toward collapse. At that time, the Labor Party (yes, the Labor Party), under the leadership of Roger Douglas, scrapped all interest rate and exchange controls, floated the New Zealand dollar, and eliminated subsidies for farming and industry,⁸ simplified the tax system, and opened up air travel to private competition.

⁴ Employment Relations Act, 2000 (N.Z.), available at <http://rangi.knowledge-basket.co.nz/gpacts/public/text/2000/an/024.html>.

⁵ For an employer view of this history, see Anne K. Knowles, *The Employment Contracts Act of 1991: An Employer History*, 290 CAL. W. INT'L L.J. 75 (1997).

⁶ Employment Conciliation and Arbitration Act, 1894 (N.Z.); See J.A.B. O'KEEFE & W.L. FARRANDS, INTRODUCTION TO NEW ZEALAND LABOR LAW 261 (1976) [hereinafter O'KEEFE & FARRANDS]. For an account of the earlier history, see Gordon Anderson, *Interpreting The Employment Contracts Act: Are the Courts Undermining the Act?*, 28 CAL. W. INT'L L.J. 117, 119-120 (1997).

⁷ Raymond Harbridge & Aaron Crawford, *The Impact of New Zealand's Employment Contracts Act on Industrial Relations*, 28 CAL. W. INT'L L.J. 235, 235 (1997). See Roger Kerr, *The New Zealand Employment Contracts Act: Its Enactment, Performance, and Implications*, 28 CAL. W. INT'L L.J. 89, 91 (1997), for a similar account.

⁸ *Id.* at 89.

The reworking of its labor law came in the second wave of legislation, which cumulated in the Employment Contracts Act 1991.

One notable feature of that Act was its cautious posture to collective bargaining arrangements of the sort that dominate American law. Critics of the ECA denounced it as an effort to curtail collective bargaining in labor markets.⁹ But I think that it is more accurate to say that the statute removed the built-in legislative tilt in favor of the system by adopting a framework that allowed individual workers to accept or reject union representation at will.¹⁰ The upshot was that any employer could always negotiate direct with workers if both of them so chose. The ECA did not so much as use the words "trade unions" in any of its provisions. Workers, as it were, may choose to bargain through representatives, but were not entitled to receive any special status under the law. Some flavor of the ECA is found in one representative provision:

19. Individual employment contracts—

(1) Where there is no applicable collective employment contract, each employee and the employer may enter into such individual employment contract, as they think fit.

(2) Where there is an applicable collective employment contract, each employee and the employer may negotiate terms and conditions on a individual basis that are not inconsistent with any terms and conditions of the applicable collective employment contract.

Yet the ECA did not achieve all the objectives sought by the reformers. In particular it left, with little guidance, a provision that allowed workers to bring personal grievances because of a claim "that the employee has been unjustifiably dismissed."¹¹ In addition, the ECA markedly expanded the jurisdiction of the specialized Employment Court that received exclusive jurisdiction to hear and determine any proceedings founded on an employment contract.¹² The propriety of the Employment Court in interpreting and enforcing the ECA had been hotly debated, but, while there is extensive argument over the propriety of their decisions, no one doubts that in the main it took positions that were sympathetic to the complaints of dissatisfied employees.

⁹ With regard to my speaking tour of 1990, it has been said that "The main intellectual source for the ECA can be traced directly back to the United States and almost exclusively to one article by Richard Epstein." Ellen J. Dannin, *Consummating Market-Based Labor Law Reform in New Zealand: Context and Reconfiguration*, 14 B.U. INT'L L.J. 267, 303 (1996). Dannin also rightly credits PENELOPE BROOK, *FREEDOM AT WORK* (1990), for making the basic case within the New Zealand Context. *Id.* at 303. See also Nick Wales, *Professor Richard Epstein and the New Zealand Employment Contracts Act: A Critique*, 28 CAL. W. INT'L L.J. 27, 27 (1997).

¹⁰ Employment Contracts Act, 1991, §§ 9, 10.

¹¹ *Id.* § 27(1)(a). See Anderson, *supra* note 6, at 119-20.

¹² Employment Contracts Act, 1991, § 3(1).

Any doubts over the proper interpretation of the ECA will not be resolved judicially because the statute has been displaced by The Employment Relations Act 2000,¹³ which totally repudiated the philosophy behind the ECA. The ERA starts with the bland declaration that its object is "to build productive employment relationships through the promotion of mutual trust and confidence."¹⁴ But far from seeing that voluntary arrangements alone can achieve that result, it veers off in another direction entirely by requiring, without defining, "good faith behaviour,"¹⁵ in negotiation. In explicit reliance on an exploitation model of labor relationships, it insists the appropriate level of employee choice can be achieved "by acknowledging and addressing the inherent inequality of bargaining power in employment relationships."¹⁶ The ERA then injects the trade union into the center of good faith negotiations. These cover not only the formation of the collective agreement and the resolution of disputes under it, but also "any proposal by an employer that might impact on the employer's employees, including a proposal to contract out work otherwise done by the employees or to sell or transfer all or part of the employer's business – "¹⁷ which may cover asset or share transactions, or only the former.

Unlike the American situation, a New Zealand collective bargaining agreement, moreover, does not confer any exclusive bargaining rights on some union selected by the majority of workers within a bargaining unit. Under the New Zealand law the duty to negotiate a collective agreement (CA) in good faith does not require a (frequently divisive) certification election similar to that required in the United States. The absence of elections in turn eliminates the need to define administratively the boundaries of the bargaining unit so as to determine which workers are eligible to participate in the election in the first place. Instead, the removal of this high election threshold in turn increases the likelihood that some trade union will be able to secure a foothold against the employer. The obligation to bargain in good faith over a CA comes into play whenever one or more unions, one or more employers, and (only) two or more employees express the desire to go that route.¹⁸

The ERA offers no definition of what counts as good faith negotiation – a point of obscurity that it shares with the NLRA. Nonetheless, it goes on to provide – again like the NLRA – that good faith negotiations do not necessarily require that the parties reach any final

¹³ Public Act No. 24, 2000 (N.Z.).

¹⁴ Employment Relations Act, 2000, § 3(a).

¹⁵ *Id.* § 3(a)(i).

¹⁶ *Id.* § 3(a)(2).

¹⁷ *Id.* § 4(4)(d).

¹⁸ *Id.* § 5 (definition of a collective agreement).

agreement or that either side make some specific concession to the other. But the requirement is not wholly toothless because it does impose a norm of full disclosure of information relevant to the claims that are asserted and denied, and, more ominously, it serves as a lever that justifies a grant of broad ministerial authority to develop and apply "Codes of good faith," that should take into account, but need not follow, the recommendation of a committee appointed to develop such codes.¹⁹

This said, ERA does not quite return to the earlier regime of compulsory industry-wide arbitration, but it certainly tilts the table in favor of union representation. Its broad declaration states that employees have the freedom to decide whether or not to join a union.²⁰ The statute then steers (no lesser word will do) workers toward that alternative via a number of subsidiary provisions. Only registered unions can represent workers under collective bargaining agreements,²¹ and these unions, but no other groups are entitled to gain reasonable access to the work place for the purpose of discussing union business or recruiting new members.²² The employer must presumptively collect union dues from salary and remit them to the union.²³ In dealing with the competition for loyalty all workers are protected from "undue influence," but while that provision is stated in neutral form, its chief purpose is to make it impermissible for employers to offer employees inducements to remain outside the union fold. In contrast, the flow of information from unions to workers is not so limited under the ERA, but is, to the contrary, subsidized. Thus the ERA also provides for mandatory paid leave for workers to receive education organized by the union that varies between five to thirty-five days.²⁴ In part the employer can counter the effectiveness of this provision by reducing the hourly wage rate to reflect the loss of productivity. But the disruption of the workforce and the possible adverse effects on morale still remain costs, even if born by employers.

The union advantage in negotiation is then increased by several related provisions. First, the presumption is that once one collective agreement is in place, then for the first 30 days all workers are bound, whether or not union members, unless they opt for some other union.²⁵ The net effect is that the same employer could be faced by multiple unions. The multiplication of unions increases the risk of competition between rival unions, which this statute resolves in part by allocating workers who have

¹⁹ *Id.* §§ 35-39.

²⁰ *Id.* §§ 7, 8.

²¹ *Id.* §§ 12-18.

²² *Id.* §§ 19-21.

²³ *Id.* § 55.

²⁴ *Id.* §§ 70-79.

²⁵ *Id.* §§ 61-63.

not chosen any particular union to that union which represents the largest number of employees at one time.²⁶ Under this regime, no employer can expect a honeymoon period in which to organize a new plant or division, for the slender requirements for invoking the collective bargaining mechanism negate any prospect of prolonged resistance to some union presence within the workforce.

The structure of good faith negotiations contemplates the possibility of bargaining to impasse, and at which point economic weapons will be brought into play. In the event of a strike or lockout, the employer prohibits the hiring of replacement workers and limits the use of existing employees to perform the work of union workers.²⁷ It also prohibits having the workers who perform any replacement work from doing so after the strike or lockout is over.²⁸ In this regard, the New Zealand scheme differs from the American system, which has always allowed the firm to hire permanent replacement workers in the event of a strike.²⁹

Within the American setting the costs of this doctrine are somewhat unclear: the firm that knows it can hire replacements may be less opposed to unionization in the first place, so that the doctrine could conceivably increase the level of union penetration. But within the New Zealand context, the results are likely to be chaotic if the rules are read to allow one union to go on strike while other workers remain. Is the firm permitted to hire new workers, up to its normal levels of recruitment, or is all hiring stopped? If some hiring is allowed, what mechanism is used to determine whether they are performing the permissible forms of work? And are these various classes of nonunion workers, new and old, bound in whole or part by any collective agreement entered into by a firm on strike? Is overtime permitted for nonunion workers, and if so, in what amounts?

Finally, the ERA micromanages contract terms. For example, it contains a provision that in every year after 2000, employers shall allow employees to meet for two hours to talk about labor and other issues, at the employer's expense.³⁰ By way of offset, the union has to give notice to the employer so that it can object if the timing and composition of the meeting compromises the ability of the employer to run his business. More critically, the ERA contains a mandatory provision requiring employers to let workers work up to as much as 35 days per year for labor education for the unions.³¹ These provisions encompass efforts, then, by the union to put

²⁶ *Id.* §§ 62(3), 63(3).

²⁷ *Id.* § 97.

²⁸ *Id.* § 97(5).

²⁹ *NLRB v. Mackay Radio & Telegraph Co.*, 304 U.S. 333 (1938).

³⁰ Employment Relations Act, 2000.

³¹ *Id.* § 74(1).

their case as strongly and firmly before the workers as possible in order to perpetuate the system at hand.

A PRIMER ON LABOR CONTRACTS: COMPETITION VERSUS EXPLOITATION

The next question is how we evaluate the stark choices that are presented by these two statutes. At the most general level, the question is how best to think about these contracts within the framework of some larger theory. In dealing with contracts, as with any other social institution, the basic challenge is how to align the incentives that govern individual actors so that when they act for their own, particular self-interest they advance some larger social interest as well. By doing so, we enlist private actors in the cause of social improvement. Under this approach, the entire structure of legal commands – whether by way of prohibition or by way of permission – is intended to create the appropriate match between private and social incentives, to the extent that human institutions are capable of so doing.

Now, looking at contracts under this particular view, what happens when people exchange capital for labor in a particular transaction? One standard view regards that transaction, in some sense, as exploitive, such that a powerful and dominant party is able to impose its will upon some hapless individual, or group of individuals, such that when the dust settles, the employer – that is, the dominant party – is left better off by virtue of this exchange while the individual who dealt with that employer is worse off as consequence of that exchange.

If someone observes that kind of situation, the proper response is to say “uh-huh, that looks to be some kind of exploitation.” Now, those people who are critical of markets, such as those who supported the ERA, would like to find exploitation, but in the end they are unable to make out the case. The reason is, quite simply, even if there is not a single alternative available to someone on the face of the entire globe, why would any party enter into a contract which they think leaves him worse off than before he entered into it at all? Why would anyone, in other words, decide to engage in an act of economic suicide in cooperation with another individual?

So what the defenders of intervention into labor markets are forced to do, in effect, is to create a more subtle definition of exploitation. One has to abandon, at least tacitly, the claim that workers are worse off when they enter into contracts with employers. The new focus is that the difference in size (or clout) between the employer and the employee is so critical that the lion’s share of the gain in the contract negotiation goes to the employer – only the scraps go to the employee. The unequal rates of return from the employment relationship, to the employer and employees respectively from cooperative venture, favors the dominant party rather than the other group in question.

This somewhat more restrained definition of exploitation leads to a series of proposals, which are supposed to allow workers to engage in activities that allow them to capture a larger portion of the cooperative gain. The ERA embodies these prescriptions with its hospitality to collective bargaining, good faith obligations, and a variety of mandatory terms that can be imposed upon these relationships. My basic position on this issue is that even this restrained view of exploitation itself is a mistake, although for somewhat different reasons than the first and broader view.

In order to figure out whether or not exploitation is taking place in the second sense, one has to distinguish very simply between two different states of the world. One state involves a single employer dealing with multiple employees with no other place to go. Because of the employees' limited mobility, the employer has an ability to extract some degree of monopoly profit, just as common carriers do when they are the only firm in a given line of business. But in the alternative second state, there are lots of different employers, some of which are the size of General Motors and some of which are the size of Epstein, Incorporated – that is, varying from the thousands to only two or three or four workers. The moment that workers have a richer menu of alternatives in the labor market, then the claim of exploitation is misplaced. If GM is prepared to offer its workers only a tiny sliver of the gains from his particular endeavors, another smaller employer-rival can offer the worker a better deal, and still make himself and the worker better off. The seas are populated not only with whales but also with minnows.

General Motors, of course, will know this prospect is in the offing so it is not going to sit back before taking countermeasures until it loses all its employees. It is going to adjust its bid in anticipation of responses from rival firms. The conclusion here is both simple and disarming. It says that if you get an employer and employee, who both have alternatives outside of the contract under negotiation, the arrangement they enter into will allow both of them to be better off. In addition, each sides behavior will be disciplined – or held in check – by virtue of the number of alternatives available and how exercising those alternatives would affect their trading profits.

Under this regime, the path to prosperity is not to create mandatory terms, not to create good faith bargaining obligations, and not to create monopoly situation of any sort. Instead, it is to simply stand aside, to let the contracts form as people will negotiate them, and then to enforce them in accordance with the terms by which they were written. Reform in this context constitutes a *reduction* in the level of legal interference with private arrangements. We should note that this is a theory not based upon some artificial assumption that government intervention in private contracts is always bad. My theory then is one which takes into account the importance of market structure in deciding whether or not the state should intervene. For example, if the firm is seeking to establish interconnections to the

telephone industry, it will not be feasible in the long run to create a system which has no government intervention whatsoever of any kind or sort of description. At the very least someone might think of how to mandate either negotiations over, or arbitration of the costs of interconnection between two separate networks.³²

THE NEW ZEALAND TRANSFORMATION

With this having been said, it is now possible to take a look at the situation in New Zealand and to discover that all is not well within many of the iterations of law reform. Before the 1894 legislation, New Zealand was a highly prosperous country. By enacting a law that imposed arbitration and reconciliation, New Zealand veered away from a competitive situation to one that required so-called “multi-employer contract arrangements.” In this instance, a given group of employers bargain unilaterally and collectively against a group of unionized workers. The constraints were so powerful that any small firm within the industry that wanted to break away from this multi-employer group were required to participate in its settlements. Similarly, any worker who wanted to break away from a union and negotiate separately was required to accept the benefits of “compulsory unionization” from the opposite side. The preferred position of these two behemoth organizations was preserved because the 1894 statute required any new entrant into the industry to join the multi-employer association and be bound by the terms the association had negotiated. What this did, in effect, was to get rid of all competition – on both the management side and labor side of any particular business.

As you might well imagine, in these kinds of powerful collective organizations, the most likely outcome is that the dominant industry firm will negotiate that set of terms. This not only gives the dominant firm a productive advantage, but also hampers any innovation that other firms in the same industry might wish to implement. So now you have not only a huge bargaining impasse that can easily take place, but also a systematic way to stifle innovation in all kinds of labor markets, including the entry of new firms, with different modes of production, who are disadvantaged by the standard form contract.

It is not, therefore, surprising that the New Zealand economy, which was one of the most prosperous in the world at the turn of the last century, became progressively weaker as labor markets deteriorated with time. Not only did New Zealand weaken their economy, but they also created an incredible series of barriers with respect to international competition in goods and services, including high tariffs, laws, and all sorts of dubious internal subsidies for foreign exports. This is not unrelated to the operation of the labor market, because the operation of this multi-

³² See Communications Act, 47 U.S.C. § 151 (1934), *amended by* Telecommunications Act, 47 U.S.C. §§ 251, 252 (1996).

employer system bargaining needs the state monopoly umbrella to prevent foreign goods produced under more favorable conditions from driving out local production. By 1984, the cumulative weight of this massively deformed system was driving the country towards bankruptcy. New Zealand had a few days worth of foreign reserves left, and they were bleeding right and left. It was a kind of a western capitalist version of East Berlin, only it occurred several years later.

Now, once a country finds itself in that kind of condition, it must recognize that there are going to be major changes introduced into its system. Indeed, New Zealand was no exception to this rule. What happened next was that the then labor-party minister, Sir Roger Douglas in treasury, took a huge meat axe and managed to change huge portions of the internal constitution of New Zealand. Exchange controls disappeared. Export restraints disappeared. Tariffs were slashed. Government agencies were privatized and sold off. In fact, when Sir Roger lectured some years later at the University of Chicago's Business School, he announced very simply what his strategy had been. These words are not quotation, but they capture his gist:

I was just moving so fast, breaking so many things up that by the time people got organized to stop me on one thing, I was done with that one, and I was on to the next, and after a while all the rats realized it was better to flee the ship by trying to be productive, rather than to try to hold up the march of reform to keep their past privileges.

By promptly taking advantage of the window of opportunity, he saved New Zealand from what would have been a major kind of international financial and business crisis.

Now, generally speaking, it is probably easier for the most part to start to reorganize exchange markets and international trade than it is to tamper with the labor market. If you are dealing with transactions between large multi-national firms, you do not quite get the capital versus labor fervor, which can easily be inserted into employment relations. However, it is not as though the Marxists really feel this is where they live or die. Even though I think people really understood that there was some connection between what happened in the international trade markets and what happened in the domestic labor markets, they could conceptually demarcate the two markets from each other.

Nevertheless, having gotten rid of the exchange controls, there was still the question of how the labor markets inside New Zealand were going to be organized. Consequently, in the period between 1984 and 1990, the government decided to make some changes. Although I think it is hard to believe these days, New Zealand had actually passed "pay equity" or "comparative worth" statute by which wages were supposed to be adjusted to reflect fairness across various trades and occupations. The nature of the enterprise was to establish some parity of wages across dominantly male and dominantly female occupations, so that if one knew the wage scale for

truck drivers, it should be possible to compute the appropriate wages for nurses. These comparisons have to be consistent both within and across various occupations, and thus contemplate a massive concentration of government power of wages, with enormous losses in productivity.

When I arrived in New Zealand in 1990, I took dead aim against this statute and argued strongly for the liberalization of labor markets, defending with gospel fervor the contract at will by which an employer could hire and fire anybody for good reason, bad reason, or no reason at all. I also spent a good deal of time explaining that if people wanted to enter into this sort of arrangement, although an outsider might think it arbitrary, in many cases it provides a perfectly sensible and workable arrangement when one understands the internal intellectual and business dynamics driving the process. The result? Half the battle was won with the enactment of the Employment Contract Act of 1991.

THE IMPACT OF THE ECA

The ECA was the focal point of fierce conflict in New Zealand, for its passage had been staunchly opposed by the trade unions, and their many supporters, including large and vocal segments of the academic community. Most evidently, the Act worked a sea of change from the Conciliation Act of 1894,³³ most obviously on the levels of unionization. The percentage of the New Zealand employees represented by unions plummeted from approaching 50 percent to below 20 percent, which gives ample indication of the high stakes in setting out the parameters of bargaining arrangements.³⁴ The reason for that decline was that unions could do little to prevent employers from taking a hard line with workers who might have otherwise wanted to negotiate through union representatives. This outcome contrasts sharply with the American position on the subject, under which all individually negotiated contracts, including those negotiated prior to the adoption of the collective bargaining agreement, are without legal effect.³⁵ Under the ECA, the union became the expendable middleman, for workers were far less willing to pay dues to organizations that could not deliver them some monopoly wage premium.

³³ Employment Conciliation and Arbitration Act, 1894; See O'KEEFE & FARRANDS, *supra* note 6.

³⁴ See Statistics New Zealand, *Labor Market Statistics 1999 – Reference Report*, at <http://www.stats.govt.nz> [hereinafter *Labor Statistics*]. In 1993 the total number of employees equally 1,160,600 of which about 409,000 were unionized, for a 35 percent figure. In 1998 the numbers were 307,000 unionized out of an employee base of 1,389,000 for a 22 percent figure. See also *ERA Info: The Report on Employment Relations in New Zealand*, Employment Relations Service, Dept. of Labour, New Zealand (July 2001), at 12, available at www.ers.dol.govt.nz.

³⁵ See *J.I. Case v. NLRB*, 321 U.S. 332 (1944) (unfair labor practice under § 8(5), imposing the duty to bargain collectively).

The decline in union membership, however, was not accompanied by a decline in overall wages or employment levels. To the contrary between 1991 and 2000 overall, around 300,000 new jobs were created, which counts as a huge increase in a country of only 3,600,000 people. Unemployment rates dropped from 11 percent in early 1992, shortly after passage of the ECA, to 6 percent in 2000.³⁶ That expansion in labor force participation is rendered still more impressive in light of the fact that overall wage levels moved up during this period. To be sure, during the first two years after the passage of the ECA, about 10 percent of workers received lower pay than before. But that is just what should be expected, for workers who had commanded large monopoly advantages under the older order could not preserve them in a more competitive environment. By the same token, once the initial corrections had been made overall wage levels went up, typically by between 2 and 5 percent under collective agreements.

In this period, productivity increased as well. Thus one estimate holds that the average growth in labor productivity increased from 1.1% per year during the 1984-1993 period to 1.9% during the 1993-1998 period.³⁷ Most noticeably, strikes were sharply reduced in number and severity. That change was doubtless correlated with the eclipse of collective bargaining. The ECA brought about a precipitate 88 percent decline in multi-employer settlements and a rapid increase (in the private sector only) of single employer settlement.³⁸ It did not have any significant effect one way or the other on the distribution of income; nor did it lead to a reduction in the percentage of the workforce holding permanent jobs. The rate of reduction in unemployment was about the same for the Maori as for the general population; it was slightly more dramatic (from a higher base) for workers from the Pacific Islands. The percentage of women in the workforce increased more rapidly than that of men.³⁹

This evidence negates any dire predictions of industrial doom from unionized markets. But by the same token their show of steady improvement has been gradual, not transformative. But that outcome is just what should be expected. Natural experiments are always messy. Any effort to understand the impact of this Act on employment has to disaggregate it from at least three other factors.

³⁶ See New Zealand Business Roundtable, *Submission on Employment Relations Bill* (May 2000) at 6-7, available at <http://www.nzbr.org.nz> [hereinafter *NZBR Submission*].

³⁷ See Diewert E. & Lawrence, D., "Measuring New Zealand's Productivity," Treasury Working Paper 99/5, New Zealand Treasury, Wellington, available at <http://www.treasury.govt.nz/workingpapers>. For summary of results, see *NZBR Submission*, *supra* note 36 (noting similar differentials in other studies).

³⁸ For an account, see Harbridge & Crawford, *supra* note 7, at 249-251 tbls.

³⁹ *NZBR Submission*, *supra* note 36, at 10. See also *Labor Statistics*, *supra* note 34.

First, wholly apart from the passage of the ECA, the position of local monopolies, including labor monopolies, was necessarily compromised by the comprehensive reforms in world trade and financial markets in the 1984 to 1990 period. Any removal of trade barriers and subsidies, the floating of exchange rates – none of which have as yet been displaced in New Zealand by protectionist legislation – necessarily reduce the value of any local monopoly, including a union monopoly over labor supply. Therefore, wholly apart from the changes in employment law, we should expect to see a reduction in labor influence, not uniformly across the board, but over time especially in import sensitive industries. In the short run, the new external competition is likely to reduce wages, but at the same time it will increase productivity and reduce prices. Overall the standard of living should improve, but not instantly or equally for all people. These theoretical variations are, however, not captured in the reported data.

Second, the effectiveness of any labor reform must be discounted by perceived uncertainty of its durability. Decisions to change the organization of a workforce are not simply made for a single slice in time. Hiring decisions have a key temporal dimension, for investments in the work force have to be matched up with those for capital equipment and brand development as part of some long-term strategic plans. The willingness to expand a workforce today – say, by hiring high-risk workers – will be dulled for an employer who fears that it will be forced to retain and manage those new workers in a heavily regulated environment tomorrow.

The ECA was a legislative enactment vulnerable to repeal the day it was passed, and it was repealed in the guise of reform nine years by a closely divided New Zealand government. The deep cleavage in public sentiment gave ample warning that a rise in populist or labor political sentiment could usher in a massive re-regulation of labor markets. In light of that possibility, established firms should be expected to cut back on expansion plans, and foreign firms should be expected to be less willing to start new operations or expand ongoing operations in New Zealand markets if they think that the country would revert to its bad old habits. The traditional British commercial practices were not always elegant, but so long as the system had the reputation of respecting vested rights, it could count on receiving a steady stream of investment. Stability matters.

Owing to New Zealand track record, however, the ECA had to be perceived in part as a Venus-fly trap that would snap shut after the foreign investment was made. The very fact that outsiders think that reforms will not be durable will contribute to their failures. The only silver lining is that poor-statutes like the ERA also have short half-lives, which in part mutes their downward draft.⁴⁰ But do not think that this problem is confined to

⁴⁰ Yet even here the matter is difficult for today New Zealand operates through coalition governments, which make it harder to get discrete changes in policy, which in turn reduces

New Zealand. The United States has not been immune to changes in policy, sometimes through bait and switch operations. The federal government actively recruited large corporations to join its pension guarantee programs with the explicit promise that they could withdraw at will. But the moment firms started to exercise those rights the trap snapped shut, with the implicit blessing of the Supreme Court.⁴¹ We shall not see a second such program.

Third, the passage of the ECA did not bring about a total deregulation of labor markets, even if it did sharply curtail labor's clout in collective bargaining. It also consolidated and strengthened its extensive human rights laws, prohibiting discrimination on multiple grounds;⁴² it kept and expanded the jurisdiction of its specialized employment court;⁴³ and it retained a host of pension, workers' compensation, health and safety mandates in labor markets. Most importantly, New Zealand retained its unjust dismissal law,⁴⁴ which, after the Act, was enforced by a specialized New Zealand labor court,⁴⁵ created and expanded for this particular purpose. Not surprisingly, the number of complaints soared from around 600 in 1990 to about 5,000 in 1998. The ECA did not introduce a regime of voluntary contract.

These unjust dismissal provisions are critical because they preclude any employer from hiring and firing at will. (There are – rightly – no analogous provisions that create a parallel wrong of unjust quitting.) If there is no union representation, and no restriction on “at will” employment relationships, a labor force will often have a high turnover rate in response to changes in technology, market forces and a firm's own strategic plan. Many workers may be reassigned or laid off, but many of those will be hired somewhere else. In steady state, we should expect, and welcome, some level of labor turnover, even if it is impossible in the abstract to pin down its ideal level.

The emergence from a system of heavy unionization meant that the labor markets were not in steady state. Quite the contrary, there was under deregulation doubtless a pent up demand on both sides of the market to shift jobs. Some workers would leave positions when stripped of the monopoly rents they accrued to unionization. Some employers would redesign their operations and seek to hire a work force consistent with their

the likelihood that the laws will be subject to radical revision or reversal. But only time will tell for sure.

⁴¹ *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211 (1986).

⁴² Human Rights Act 1993, 2 Stat. 82 (N.Z.), available at <http://rangi.knowledge-basket.co.nz/gpacts/public/text/1993/an/082.html>.

⁴³ Employment Contracts Act, 1991, § 3. See O'KEEFE & FARRANDS, *supra* note 6.

⁴⁴ Employment Contracts Act, 1991, § 27(a). See O'KEEFE & FARRANDS, *supra* note 6.

⁴⁵ See O'KEEFE & FARRANDS, *supra* note 6.

new business plan. That is exactly what happened in New Zealand, which experienced a high rate of turnover shortly after the adoption of the ECA. In fact, any worker that enjoyed the benefit of monopoly protection could easily have done worse under the new regulatory scheme and soon came to resent it, which could help explain the spurt in unjust dismissal claims after the advent of the act. The level of legal activity was doubtless increased when employees perceived that they have the advantage of a specialized tribunal.

These are also trumpeted because of their expertise, but they should fall under suspicion because of their bias. Professor Andrew Morriss, among others, has written about the track record of this and other specialized courts, and he has delivered a mixed verdict as to their institutional efficacy.⁴⁶ On matters of patent and tax law, the demand for technical knowledge is so high that some resort to specialized tribunals is appropriate. In my opinion, labor contracts do not fall into that select group of technical issues. Interpreting and enforcing these contracts is not all that different from similar activities with any commercial or business contracts. The judges and lawyers have to be able to read the contract language in light of the background business arrangements. Any lawyer who knows something about the sale of goods or the formation of partnerships is likely to do better in understanding labor contracts than lawyers who have immersed themselves in employment contracts for all their lives. Consequently, I see no need for a specialized dispute resolution system for these contractual issues.

The danger here is evident. Specialized courts, while praised for their ostensible expertise, are dangerous because of the ability of a determined legislature to pack them. A specialized court allows a party to put their pigeons in place so that the folks who are on that court can have a systematic buy, pushing them in one direction or another. Indeed New Zealand's labor court was both strong, and pro-employee, so new life was breathed into these unjust dismissal claims simply by virtue of the fact that there was a systematic framework. Although these verdicts for the employees were often reversed by the appellate courts, every experienced lawyer knows that a victory at trial creates leverage on appeal. Thus, New Zealand labor law was buffeted by two forces moving in opposite directions, as the liberalization from the unions was matched by increased judicial activity with unjust dismissal cases. The question is how these two influences sum in labor markets. Here, my guess is that the overall estimate shows that the ECA was a positive contribution on net, but the conflicting trends require a modification of caution on the issue.

⁴⁶ Andrew P. Morriss, *Specialized Labor and Employment Institutions in New Zealand and the United States*, 28 CAL. W. INT'L L. J. 145 (1997).

THE EMPLOYMENT RELATIONS ACT OF 2000

Now that the Employment Relations Act of 2000 has supplanted, as of October of 2000, the ECA, what is its impact? Here the time is too short to have a definitive analysis, but some initial findings are in. The public response to the Act seems to be guardedly sympathetic, and union membership has not climbed dramatically, even though there has been a sharp increase in the number of days lost to strikes – 441 days for a three month period under the ECA in the spring of 2000 to 6069 days in the like period for 2001.⁴⁷ The internal organizational design of the ERA, however, presents troublesome features that make me long for the American National Labor Relations Act. The precise difficulties in implementation of this broad scheme are impossible to resolve in the abstract, for the ERA, with its good faith standard,⁴⁸ is often loosely drawn and will doubtless prove vulnerable to the vagaries of administrative enforcement and judicial interpretation. It thus makes an appeal to the familiar misguided and confused claims about inequality of bargaining power, good faith negotiation, and freedom of association that have long bedeviled labor regulations elsewhere. Like the American Statute, the ERA does not compel either side to make concessions to the other – for otherwise each would be required to accept the terms of its opponents.⁴⁹ But it does make the niceties of negotiation matter, so that “take it or leave offers,” (of the kind found in every supermarket) become suspect. The level of stylized bargaining will increase, and so will the need to observe procedural niceties. In perfect competition transactions costs are driven toward zero while the velocity of transaction increases. Under collective bargaining the transaction costs go up and the rate of exchange goes down – a bad trade all around.

In a sense the situation in New Zealand is, I fear, still worse than that under the NLRA because of differences in the enforcement of the collective bargaining regimes. The NLRA creates the National Labor Relations Board, which is a quasi-judicial operation designed to resolve unfair labor practice disputes, contractual disputes, and all other issues that arise under the NLRA. In New Zealand, however, the minister is given very broad discretion to enter and to propose codes of industry conduct, which are in turn designed to implement the good faith duties embodied under the ERA.

The new regime brings back shades of New Zealand's 1894 Conciliation Act, with its destructive multi-employer bargaining system. One way to return to industry-wide bargaining is for the minister to propose

⁴⁷ See Deborah Hill Cone, *Increasing strikes fail to change public's sunny view of ERA*, THE NAT'L BUS. REV., Oct. 12, 2001.

⁴⁸ Employment Relations Act, 2000, § 4(1)(a).

⁴⁹ *Id.*

a code of good faith negotiation. That norm would bind every firm in a particular industry and thus introduce industry-wide cartelization via the back-door imposition of minimum terms. The statute also micromanages the substantive provisions of employment contracts. The combination is likely to prove very destructive.

The larger lesson that one should learn from the passage of the ERA is not intellectual but political. The fight over labor organizations is a fight between two visions: competition and exploitation. The former sees competition in labor markets as a dynamic source of improvement for all participants in the market. The disappointed job seeker in one case benefits from the range of alternatives that are opened by the greater willingness of firms to enter labor markets in the first place. Monopoly arrangements cut down on entry and experimentation in labor markets, just as it does in product markets. The standard position, which is deeply suspicious of special pleading, sees nothing "special" about labor markets and thus applies to them the same principles that are used in structuring contracts for everything from the sale of a loaf of bread to the sale of a corporation. No matter what the context, those principles only justify the state sponsorship of monopoly in limited circumstances, as a precondition to public order – as with the system of law enforcement – or as an inducement to innovation, as with patents and copyrights. Happily, labor markets need no special tweaking to become and remain highly competitive. But they are regrettably exposed to concerted political action that can make them rigid, unresponsive, and conflict-ridden. Such are the social consequences of the alternative political vision when the political rhetoric behind labor law sees exploitation in competition and just redress in protectionist rules.

The ERA responds to this fundamental political choice by embracing the latter vision. My prediction is that it will prove difficult to tame the powerful economic forces that legislation such as the ERA unleashes. The question of how this, or any other, legislation will alter the balance of power is, however, hard to predict in the abstract. On this matter the point of durability works, as it were, in reverse. The trade union that thinks that this round of law reform will be of short duration will reduce accordingly its efforts to gain dominance in the workplace. If New Zealand remains open to international competition, then the domestic power of unions will be blunted by economic forces from without, no matter what the ERA provides. But if the forces that secured passage of the ERA conclude that open borders have undercut the effectiveness of the union campaign, then the ripple effects from the ERA could undo the fundamental trade and financial reforms spearheaded by Roger Douglas during the 1980s. The intellectual arguments on this issue remain what they were before the statute was passed. Its economic consequences will prove, I fear, a graver concern.

